ORIGINAL

Bell Atlantic
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Washington, DC 20005

Kenneth Rust
Director, Federal Regulatory Affairs

September 10, 1999

EX PARTE OR LATE FILED

Ex Parte

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

Re: CC Docket Nos. 96-45 & 97-160

Dear Ms. Salas:

Yesterday, Ed Lowry, Pat Garzillo, Vin Callahan and I, representing Bell Atlantic, and Harold Ware of NERA, met with Lisa Zaina, Katherine Schroder, Don Stockdale, Katie King and Chuck Keller of the Common Carrier Bureau, regarding the items captioned above. Due to the late hour at which the meeting ended, a formal notification of the ex parte presentation could not be filed until today. The attached material served as the basis for the discussion throughout the meeting.

Any questions on this filing should be directed to me at the address shown above.

Sincerely,

Attachments

cc: Mr. C. Keller
Ms. K. King
Ms. K. Schroder
Mr. D. Stockdale
Ms. L. Zaina

A MODEL PROBLEM

Vincent Callahan
Bell Atlantic

A MODEL PROBLEM

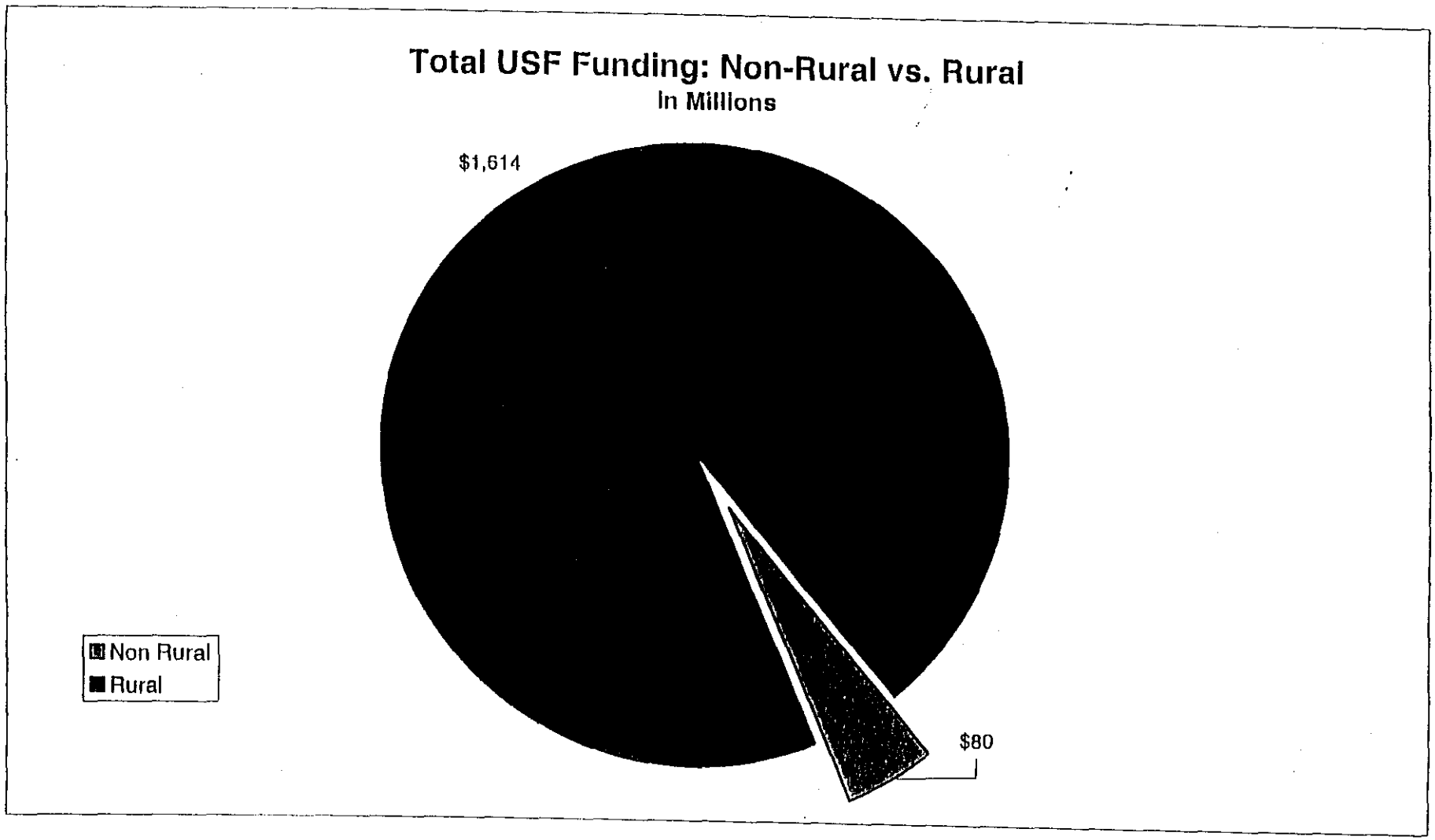
- The Size of the Problem:
  - Total Universal Service Fund = $1.7 Billion*
  - Total Non-Rural Company Universal Service Funding = $80 Million*

» (Attachments A-C)

* Source: Universal Service Administrative Company's Third Quarter 1999 Report, Appendix1, 4/26/99.

HCPM Update
USAC's 3rd Qtr. 1999 Report

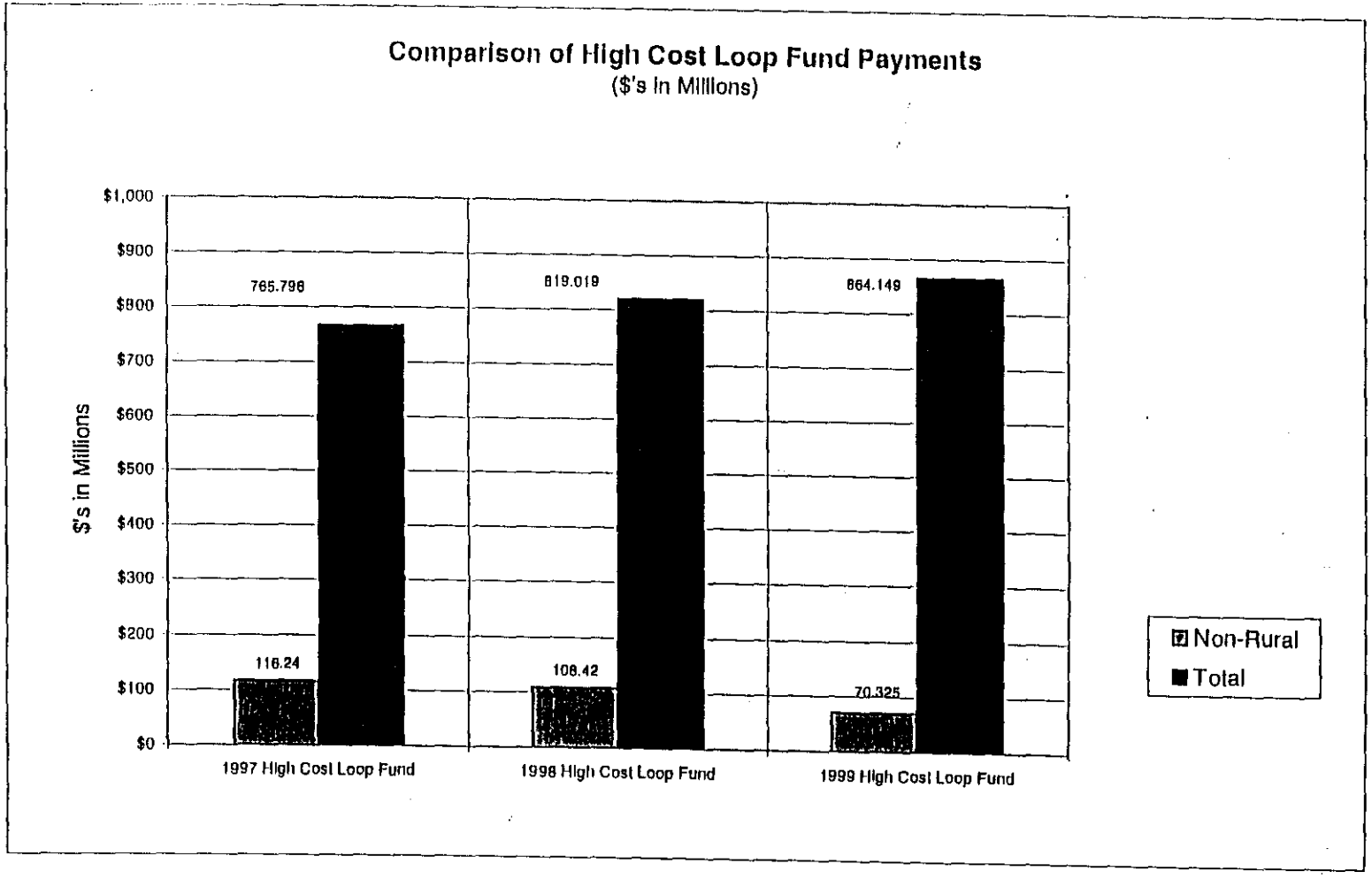
Attachment A



* All Puerto Rico operating companies categorized as rural.

HCPM Update

Attachment B

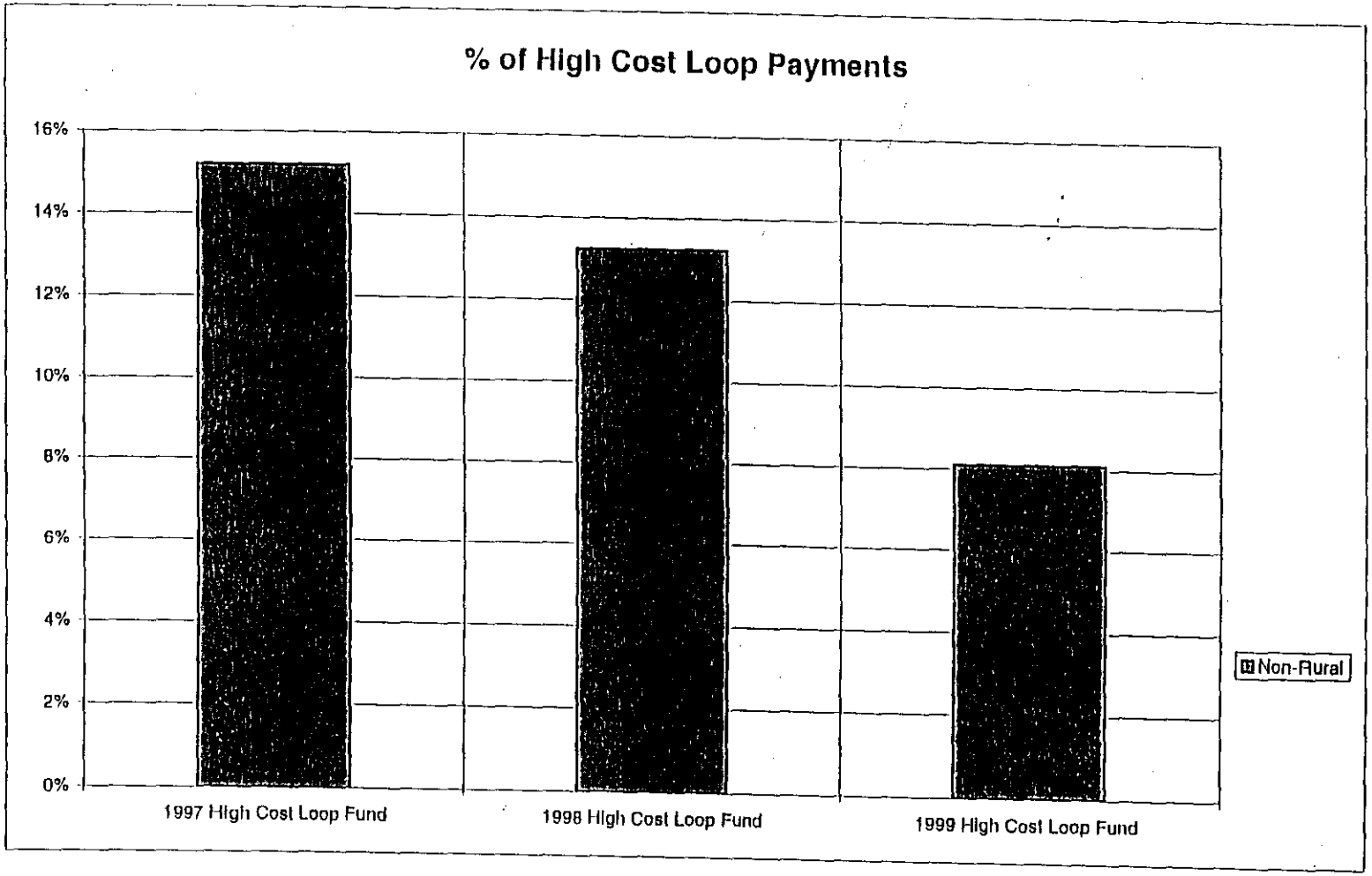


1997 and 1998 Data Source: FCC Monitoring Report, 7/99.

1999 Data Source: USAC 3rd Quarter 1999 Fund Size Projections, 4/99.

HCPM Update

Attachment C



1997 and 1998 Data Source: FCC Monitoring Report, 7/99.

1999 Data Source: USAC 3rd Quarter 1999 Fund Size Projections, 4/99.

A MODEL PROBLEM

- Can The HCPM Be Used To Size The Fund?

Benchmark	Density Zone Annual Support	Wire Center Annual Support
115%	$ 2,463,244,907	$ 5,077,192,086
125%	$ 1,841,116,132	$ 4,483,544,196
135%	$ 1,404,342,402	$ 3,987,635,682
150%	$ 924,605,344	$ 3,380,171,514

A MODEL PROBLEM

- Can the HCPM be used to distribute Universal Service Funding?

  » (Attachment D)

Inflow/Outflow
135% Benchmark
$2 Per Line State Responsibility

Non-Rural Funding Projections
Incremental Impact by State

Attachment D
Interstate End-User Revenues Only

State	Forward Looking	State Responsibility	Net Forward Looking Support	Current Non-Rural Support	Non-Rural Hold Harmless	Funding Difference	Incremental Outflow	Incremental Non-rural Net Inflow/Outflow
AL	$ 108,509,266	$ 49,827,360	$ 58,681,906	$ 11,171,412	$ 58,681,906	$ 47,510,494	$ 4,255,208	$ 43,255,286
AR	$ -	$ -	$ -	$ 3,831,120	$ 3,831,120	$ -	$ 2,571,780	$ (2,571,780)
AZ	$ -	$ -	$ -	$ 1,952,712	$ 1,952,712	$ -	$ 6,222,908	$ (6,222,908)
CA	$ 30,298,846	$ 30,298,846	$ -	$ 5,892,408	$ 5,892,408	$ -	$ 29,848,639	$ (29,848,639)
CO	$ -	$ -	$ -	$ 2,254,764	$ 2,254,764	$ -	$ 6,262,884	$ (6,262,884)
CT	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,148,002	$ (5,148,002)
DC	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,687,869	$ (1,687,869)
DE	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,212,601	$ (1,212,601)
FL	$ -	$ -	$ -	$ -	$ -	$ -	$ 20,631,983	$ (20,631,983)
GA	$ -	$ -	$ -	$ 2,328,384	$ 2,328,384	$ -	$ 10,033,940	$ (10,033,940)
HI	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,270,344	$ (1,270,344)
IA	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,020,398	$ (3,020,398)
ID	$ -	$ -	$ -	$ 935,448	$ 935,448	$ -	$ 1,581,267	$ (1,581,267)
IL	$ 106,260,516	$ 106,260,516	$ -	$ -	$ -	$ -	$ 13,494,072	$ (13,494,072)
IN	$ 36,645,478	$ 36,645,478	$ -	$ -	$ -	$ -	$ 5,743,198	$ (5,743,198)
KS	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,038,165	$ (3,038,165)
KY	$ 51,090,749	$ 41,275,992	$ 9,814,757	$ 1,269,504	$ 9,814,757	$ 8,545,253	$ 3,873,216	$ 4,672,036
LA	$ -	$ -	$ -	$ -	$ -	$ -	$ 4,206,348	$ (4,206,348)
MA	$ -	$ -	$ -	$ -	$ -	$ -	$ 8,625,901	$ (8,625,901)
MD	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,840,313	$ (6,840,313)
ME	$ 16,682,032	$ 15,105,960	$ 1,576,072	$ -	$ 1,576,072	$ 1,576,072	$ 1,394,713	$ 181,359
MI	$ 82,436,625	$ 82,436,625	$ -	$ 661,776	$ 661,776	$ -	$ 8,652,552	$ (8,652,552)
MN	$ 51,868,235	$ 51,868,235	$ -	$ -	$ -	$ -	$ 5,361,206	$ (5,361,206)
MO	$ 94,784,794	$ 65,330,376	$ 29,454,418	$ 6,769,032	$ 29,454,418	$ 22,685,386	$ 5,832,033	$ 16,853,353
MS	$ 163,779,877	$ 29,381,064	$ 134,398,813	$ 7,137,924	$ 134,398,813	$ 127,260,889	$ 2,545,130	$ 124,715,759
MT	$ 11,140,796	$ 8,076,936	$ 3,063,860	$ 1,726,752	$ 3,063,860	$ 1,337,108	$ 1,154,858	$ 182,250
NC	$ 111,159,036	$ 93,221,880	$ 17,937,156	$ 8,099,088	$ 17,937,156	$ 9,838,068	$ 8,759,154	$ 1,078,914
ND	$ -	$ -	$ -	$ -	$ -	$ -	$ 870,585	$ (870,585)
NE	$ 12,641,325	$ 12,641,325	$ -	$ 812,004	$ 812,004	$ -	$ 1,927,725	$ (1,927,725)
NH	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,100,953	$ (2,100,953)
NJ	$ -	$ -	$ -	$ -	$ -	$ -	$ 13,676,185	$ (13,676,185)
NM	$ -	$ -	$ -	$ 4,509,540	$ 4,509,540	$ -	$ 2,149,813	$ (2,149,813)
NV	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,998,189	$ (2,998,189)
NY	$ -	$ -	$ -	$ -	$ -	$ -	$ 22,661,869	$ (22,661,869)
OH	$ 119,444,545	$ 119,444,545	$ -	$ -	$ -	$ -	$ 10,504,767	$ (10,504,767)
OK	$ 9,021,862	$ 9,021,862	$ -	$ -	$ -	$ -	$ 3,473,458	$ (3,473,458)
OR	$ -	$ -	$ -	$ -	$ -	$ -	$ 4,050,887	$ (4,050,887)
PA	$ -	$ -	$ -	$ -	$ -	$ -	$ 13,320,844	$ (13,320,844)
RI	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,421,364	$ (1,421,364)
SC	$ 3,720,381	$ 3,720,381	$ -	$ 5,348,724	$ 5,348,724	$ -	$ 4,432,878	$ (4,432,878)
SD	$ 342,508	$ 342,508	$ -	$ -	$ -	$ -	$ 937,212	$ (937,212)
TN	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,200,699	$ (6,200,699)
TX	$ 104,832,951	$ 104,832,951	$ -	$ 5,399,124	$ 5,399,124	$ -	$ 19,104,017	$ (19,104,017)
UT	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,363,017	$ (2,363,017)
VA	$ 99,313,903	$ 96,525,528	$ 2,788,375	$ 1,216,500	$ 2,788,375	$ 1,571,875	$ 9,207,772	$ (7,635,897)
VT	$ 16,089,113	$ 7,520,616	$ 8,568,497	$ 1,400,040	$ 8,568,497	$ 7,168,457	$ 915,003	$ 6,253,454
WA	$ -	$ -	$ -	$ -	$ -	$ -	$ 6,800,337	$ (6,800,337)
WI	$ 93,532,687	$ 59,085,048	$ 34,447,639	$ -	$ 34,447,639	$ 34,447,639	$ 5,005,866	$ 29,441,773
WV	$ 63,505,985	$ 18,572,616	$ 44,933,369	$ 1,715,976	$ 44,933,369	$ 43,217,393	$ 1,807,797	$ 41,409,596
WY	$ 17,240,895	$ 5,422,800	$ 11,818,095	$ 4,503,228	$ 11,818,095	$ 7,314,867	$ 746,216	$ 6,568,651
Total	$ 1,404,342,402	$ 1,046,859,447	$ 357,482,956	$ 78,935,460	$ 391,408,960	$ 312,473,500	$ 309,946,137	$ 2,527,362
AK	$ -						$ 817,284	$ (817,284)
GU	$ -						$ 133,253	$ (133,253)
CNMI	$ -						$ 17,767	$ (17,767)
PR	$ -						$ 1,385,830	$ (1,385,830)
VI	$ -						$ 173,229	$ (173,229)
Total	$ 1,404,342,402	$ 1,046,859,447	$ 357,482,956	$ 78,935,460	$ 391,408,960	$ 312,473,500	$ 312,473,500	$ (0)

Derived from the FCC's HCPM (6/1/99 - density zone) set with a benchmark of 135% above the national average monthly cost.
State responsibility in high cost states set at $2.00 per line.
Current Non-Rural Support taken from USAC's Third Quarter 1999 Report, Appendix 1, 4/99.
Total End User Telephone Revenues taken from Table 10 of the State-by-State Telephone Revenue and Universal Service Data, FCC, 1/99.

A MODEL PROBLEM

A solution in search of a problem:

Current high-cost support sufficient

- High penetration rates

Non-rural support is 5% of current fund

- Percentage decreasing over time

A MODEL PROBLEM

A solution in search of a problem:

- No need to identify additional Intrastate high cost support
- A model not needed to identify Interstate (implicit) support, e.g., CALLS proposal

A MODEL PROBLEM

SUMMARY:

- Model produces unrealistic results
- Questionable need for more support
- Questionable distribution of new funds
- Potential for economic distortion and political tension
- Deal with non-rural support when treating support for rural carriers

The Proposed Proxy Model Inputs Understate Costs and Are Based on Flawed Analyses
(Summary of H. Ware and C. Dippon's Affidavit, Filed July 23, 1999)

- **By failing to account for switch growth and upgrades, the proposed switch cost inputs understate switch investments.**
  - Inputs exclude the costs of adding new lines for growth, and of upgrading switching equipment and software.
  - Inputs assume all switches are deployed instantaneously at a single point in time using only new lines.
  - Switch vendors offer much higher discounts for new switching capacity, than for growth lines and upgrades.
  - Inputs substantially understate switch costs.

- **Cost models and inputs must reflect that all firms operate in a world in which demand grows and shifts, and in which facilities will be upgraded, and replaced.**

- **If the Commission assumes there are no growth jobs—contrary to how real firms deploy switches—then it should change its assumptions about excess capacity, depreciation, and/or replacement costs. Each of these changes would raise costs.**

- **The switch cost study used to estimate the model's switch cost inputs understates costs and has serious flaws.**
  - It excluded information regarding add-on lines and upgrade costs for new software and hardware after initial replacement.
  - The data set used in the study is not representative.
  - The data set omits key variables and leads to biased estimators.

- **The outside plant model ignores wireless local access options.**

- **The NRRI cable cost study used to develop the model's cable costs has serious flaws. It should not be used because it:**

    - Is based only on Rural Utilities Services' data. These data are not representative of non-rural LEC costs.

    - Ignored many of the actual costs incurred by ILECs (e.g., acquiring rights-of-way, supervision, and safety precautions).

    - Uses arbitrary allocations to estimate separate unit costs based on total project costs.

    - Does not contain sufficient information to distinguish between costs for underground and buried cable, although the FCC Model has separate costs for each structure type.

    - Is based on flawed econometric models. (See Sections IV C and D of our affidavit.)

- **An alternative:**

    - Obtain more accurate cost inputs directly from the non-rural LECs.

    - Use cost inputs that are as specific to each area as possible to better identify high-cost areas.

- **Basing universal service support on a study that measures the costs of a hypothetical network sized to serve a static level of demand understates the forward-looking costs that ILECs need to recover to provide universal service.**

- **As a result of the flaws noted, using the proposed inputs and cost model as presently structured would likely generate incorrect cost estimates and, thus, lead to inefficient public policy outcomes.**

Bell Atlantic
Model Inputs

- Model inputs are consistently understated
  - Cable and Wire
  - Structure Sharing
  - Switching
- Model logic is fatally flawed
- Inputs and logic produce invalid results
- Results produce questionable Public Policy

Bell Atlantic
Cable and Wire

- Inputs are largely understated
  - Serving Area Interface (SAI)
    - FCC recommended inputs are lower than Bell Atlantic's and earlier FCC workshop values.
    - Right-of-way cost are not included
  - Digital Loop Carrier (DLC)
    - AT&T analysis did not include COT and RT line card cost
- Results understate Cable & Wire

Bell Atlantic
Structure Sharing

- Recommended inputs are overstated
- FCC data request provided actual data
- Proposed level of sharing has never been realized in the actual network

Bell Atlantic
Switching Cost

- Model switching logic fails to include growth and upgrades
- AT&T misrepresented Bell Atlantic material cost as fully installed cost
- Validation of FCC Model Switching Curve
  - Used FCC switching curve as input
  - Produced BA-NY switching offices
  - Compared actual installed cost to FCC model results
- FCC model switching curve understated switching cost by 41%